United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

To be argued by
OSMOND K. FRAENKEL

77-7169

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P/S

IN THE

United States Court of Appeals

For the Second Circuit

No. 77-7169

ABNER HARKAVY,

Plaintiff-Appellant,

—against—

APPAREL INDUSTRIES, INC. and S. M. ELOWSKY,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR APPELLANT

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To be argued by
Osmond K. Fraenkel

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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ABNER HARKAVY,

Plaintiff-Appellant

v.

Docket No. 77-7169

APPAREL INDUSTRIES, INC. and
S. M. ELOWSKY,

Defendants-Appellees

----------X

APPELLANT'S BRIEF

This is an appeal from a judgment dismissing plaintiff's complaint after trial before Judge Bonsal in the Southern District (164a, 166a). His opinion is not yet reported.

THE ISSUES

The Court erred in dismissing the complaint since plaintiff established that defendants withheld material information, knowledge of which would have affected his willingness to sell his stock.

STATEMENT OF THE CASE

Plaintiff sued to recover damages on the ground that he had not been informed of material matters at the time

he sold his stock in defendant corporation, Apparel Industries, Inc., to that corporation, and that this failure violated the Securities Exchange Act of 1934 [15 USC §78j(b) and Rule 10b-5] of the Securities and Exchange Commission.

The facts are not in dispute. Plaintiff had been an employee of a predecessor of Apparel, Kordeen Mfg. Co., Inc. (4a, 5a), and had acquired its stock which, after a reorganization, amounted to 3,366 shares of Apparel (12a).

On March 13, 1969 plaintiff approached defendant Elowsky, president of Apparel, in connection with the sale of his shares (10a-13a). Elowsky told him that business was bad and that the company was losing money (11a). Plaintiff then sold 366 shares at the book value of $4 (85a). In January 1970 he sold the remaining 3,000 shares at book value of $4.43 (88a), again after Elowsky had told him that the business prospects of the corporation were poor (13a-17a).

Much later, indeed not until 1975 (24a), plaintiff learned that on November 12, 1969 an article had appeared in Women's Wear Daily (Plaintiff's Exh. 3; 227a) in which it was stated that Apparel and defendant Elowsky were working on plans to open a junior operation "and that this was coming in the not too distant future." The article further noted that this was something Elowsky had wanted for a long time. The accuracy of the article was conceded (74a).

To understand the significance of this announcement, it is important to note that Apparel had sold a profitable junior wear division in 1964 under an agreement that prevented Apparel from producing junior sportswear for four years (26a).

In fact, Apparel marketed its new junior line in July or August 1970 (100a). For this purpose it employed Mr. Grey, a designer, in April, and Mr. Bag, a manager, in July (115a). This turned the operations of Apparel profitable after losses in both 1968 and 1969 (see Plaintiff's Exh. 2, 196a ff).

On March 10, 1969 Apparel entered into an agreement with four shareholders of House of Morrison (Plaintiff's Exh. 1; 167a-195a) which gave Apparel the first refusal for its stock it had given them in exchange for their Morrison stock, and authorized Elowsky to buy Apparel stock from other shareholders. Just before Apparel bought the last 3,000 shares from plaintiff, it bought over 10% of its capital stock from two of the Morrison stockholders (22a, 23a, 47a). Plaintiff was not told of the provisions of this agreement (19a), nor of the purchases (22a, 23a).

Plaintiff testified that if he had known of the agreement it would have affected his decision about selling, as purchases of other shares by the company would have made his more valuable (20a).

Judge Bonsal held that plaintiff had not met his burden of proof (163a). His decision rested largely on the

circumstance that the junior line had not actually been marketed until the autumn of 1970 (162a). He gave no consideration to any possible impact knowledge of the Women's Wear Daily article would have had on plaintiff's readiness to sell the 3,000 shares which were sold in January 1970.

POINT I

THE COURT ERRED IN DISMISSING THE COMPLAINT SINCE PLAINTIFF ESTABLISHED THAT DEFENDANTS WITHHELD MATERIAL INFORMATION, KNOWLEDGE OF WHICH WOULD HAVE AFFECTED HIS WILLINGNESS TO SELL HIS STOCK.

It was undisputed at the trial that defendants had not informed plaintiff at the time of the purchase of the 3,000 shares in January 1970 of the article in Women's Wear Daily which indicated their intention soon to resume the profitable junior line. It was likewise undisputed that they had not informed plaintiff of the details of the agreement entered into with four of the House of Morris stockholders or of the purchase of over 10% of the corporation's stock from two of them.

Defendants' intention is clearly stated in the November 1969 Women's Wear Daily article (Plaintiff's Exh. 3, 227a). It was acted on early in 1970 and turned a losing venture into a profitable one. There can be no doubt that if plaintiff had

been aware of this he would not have sold his 3,000 shares at book value.

Judge Bonsal in his opinion (162a) referred to the Women's Wear Daily article only casually and, in his listing of plaintiff's grievances (161a), he altogether omits reference to this article. The Judge stressed the testimony of defendants' witnesses that promotion of the junior line was not begun until April 1970 (162a). That, of course, begs the question. It was not the time of actual activity that mattered but the fact that in November 1969 defendants were thinking about taking that action "in the not too distant future" 227a). Plaintiff was entitled to be informed of this. It is not disputed that he was not.

The importance of the junior operation, known as "Trousers Up" (67a, 68a), is disclosed in the 1972 prospectus (Plaintiff's Exh. 2). The change from a loss of $234,458 in 1969 to a profit of $255,699 in 1970 and $465,023 in 1971 is there attributed to increased sales of that line which was introduced in the fall selling season of 1970. It was stated that the company was a "fashion leader" under that label.

At the trial, Douglas H. Bellemore, an expert in matters relating to stock transactions and investments (46a), testified that a "reasonable investor" would not have sold

his stock had he been informed of the company's repurchase of more than 10% of the capitalization (48a) and of the company's intention to resume the junior line (49a).

In SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, the Court, at page 849, expressly held that facts were material to which "a reasonable man would attach importance." See also List v. Fashion Park, Inc., 340 F.2d 457.

See also Matter of Charles A. Howard, 1 SEC 6, and Matter of Investors Management, 44 SEC 633.

Defendants produced no expert to contradict this testimony. It was ignored by Judge Bonsal in his opinion. He referred to the additional purchases only to the extent of noting that the price paid was the same as paid to plaintiff (160a). That, of course, begs the question whether plaintiff did not have the right to know of these purchases in January 1970, before deciding to sell his remaining 3,000 shares.

That the corporation considered these purchases material is shown by its inclusion of references to them in the 1972 Registration Statement, Plaintiff's Exh. 2.

The rule governing situations like this was set forth in Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972). There the Court said at page 151:

"These proscriptions, by statute and rule, are broad and, by repeated use of the word 'any,' are obviously meant to be inclusive. The Court has said that the 1934 Act and its companion legislative enactments embrace a 'fundamental purpose . . . to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.' SEC v. Capital Gains Research Bureau, 375 U.S. 180, 186 (1973)."

We submit the situation here is governed by Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965). There, as here, the company had been doing poorly. There the president of the company failed to disclose that it had a backlog of orders that would make it profitable in the future. The Court held that the failure to disclose was a basis for a suit for damages.

So in Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967), the Court held that the failure to disclose increased sales was a material omission which justified the action.

To like effect are Speed v. Transamerica Corp., 99 F. Supp. 808 (D. Del. 1951), and In re Ward LaFrance Truck Corp., 13 SEC 373 (1943).

Under all these authorities plaintiff sustained the requisite burden of establishing the omission of material facts and it was error to dismiss his complaint.

Judge Bonsal cited no case in which similar omissions were held not material. The two cases he did cite as supporting

his conclusion (163a) do not support him. For in each of those cases the Court found that there had been withholding of material information.

CONCLUSION

Plaintiff established the withholding of material information and was entitled to prove his damages. The judgment appealed from should be reversed and the case remanded.

Respectfully submitted,

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Attorneys for Appellant.

OSMOND K. FRAENKEL
DAVID BROWN
Of Counsel

Service of three (3) copies of the within
is hereby admitted

this 13th day of July 1977

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Attorney(s) for Defendants-Appellees

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